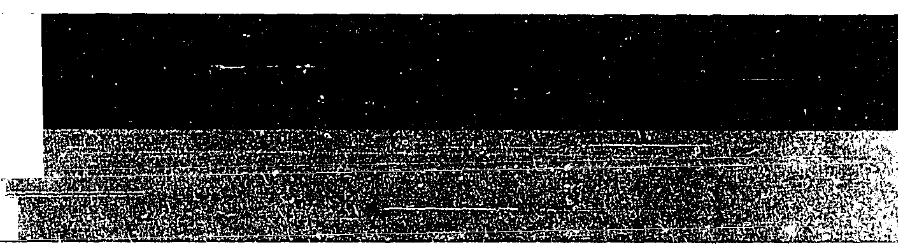
Hart Schaffner & Marx

Annual Report 1978

America's leading maker
and retailer
of quality apparel.



Board of Directors

John D. Gray ●
Chairman, Hart Schaffner & Marx

Jerome S. Gore ●
President and Chief Executive Officer, Hart Schaffner & Marx

A. Robert Abboud ● ○ ● ●
Chairman of the Board of First Chicago Corporation
and of The First National Bank of Chicago

Lee S. Bickmore ● ○ ●
Chairman, Executive Committee, Nabisco, Inc.

Charles L. Brown ● ○ ● ●
Chairman and Chief Executive Officer,
American Telephone and Telegraph Company

James F. Chambers, Jr. ● ○ ●
Chairman of the Board and Chief Executive Officer,
The Times Herald Printing Company (Dallas)

Paul A. Conley ● ○ ●
Financial Consultant; retired Chairman of the Board,
Blyth Eastman Dillon & Co. Incorporated

James E. Devitt ● ○ ●
President and Chief Executive Officer,
The Mutual Life Insurance Company of New York

Arthur Gunzberg
Chairman, M. Wile & Company, Inc.

John R. Meinert
Executive Vice President, Hart Schaffner & Marx

Burton B. Ruby
President, Jaymar-Ruby, Inc.

Elmer Schlesinger ● ○ ●
Investor

Honorary Directors

Walter M. Heymann
Retired (former Vice Chairman, The First National Bank of Chicago)

Walter B. D. Hickey, Sr.
Chairman, Hickey-Freeman Co., Inc.

J. M. Ruby
Chairman, Jaymar-Ruby, Inc.

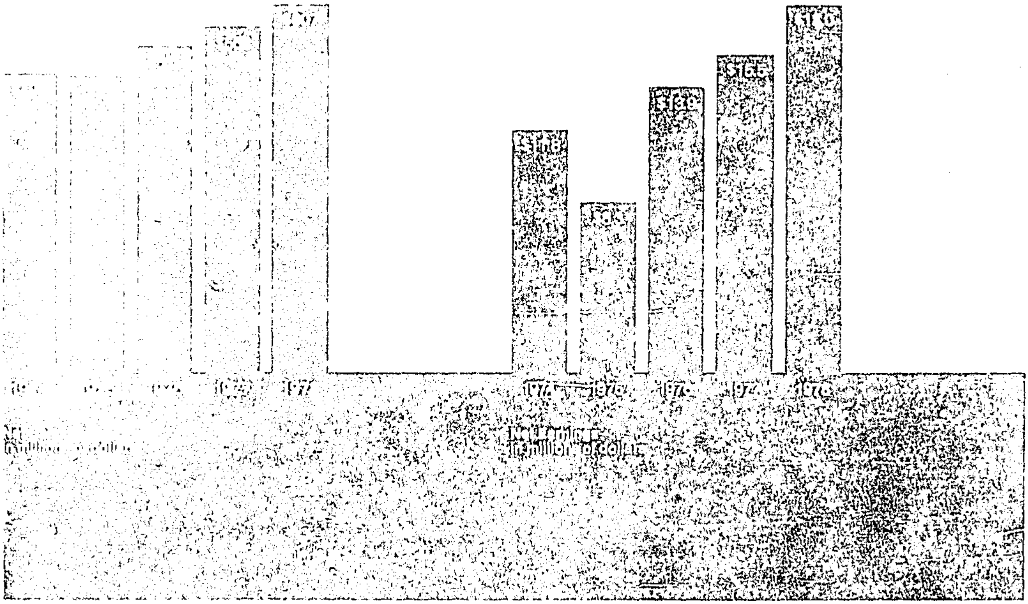
Clay E. Steele
Retired (former Senior Vice President, Hart Schaffner & Marx)

● Executive Committee
○ Audit Committee
● Compensation and Stock Option Committee
● Director Selection Committee

Highlights

Hart Schaffner & Marx and Subsidiary Companies

Years ended November 30	Increase	1978	1977	
Operating Results	+ 7%	**$606,610,000**	$567,986,000	Net Sales
	+16%	**18,005,000**	15,505,000	Net Earnings
Shareholder Financial Data	+16%	**2.09**	1.80	Earnings per share
	+11%	**.80**	.72	Cash dividends per common share
	+ 6%	**199,951,000**	188,792,000	Shareholders' equity
	+ 6%	**23.35**	22.05	Equity per share
		8,601,000	8,601,000	Average number of common shares and common share equivalents
		8,900	8,900	Number of shareholders



To Our Shareholders:
February 12, 1979

Hart Schaffner & Marx established record sales and earnings for fiscal 1978. For the first time in your Company's ninety-one year history, sales surpassed the $600 million mark and earnings exceeded $18 million. Manufacturing and retailing operations both achieved record sales and earnings for the year.

Financial Results
Sales increased 6.8 percent to $606,610,000 in 1978 from $567,986,000 in 1977. Earnings increased 16.1 percent to $18,005,000 or $2.09 per share for 1978 from $15,505,000 or $1.80 per share for 1977.

Your directors increased the February, 1979 dividend by 10 percent to 22 cents from the 20 cents per share paid quarterly during 1978. The directors also authorized purchases on the market of up to an aggregate of 100,000 common shares to be used for general corporate purposes.

Shareholders' equity grew during 1978 to $200 million or $23.35 per share while long term debt was reduced to $53.7 million, or only 21 percent of the $253.7 million capitalization. Return on average equity of $194 million improved to 9.3 percent in 1978 from 8.4 percent in 1977, 8 percent in 1976 and 5 percent in 1975. Earnings increased as a percentage of sales in 1978. Our plans for achieving higher returns on investment call for expanding, increasing our earnings and faster turnover of assets, particularly inventory. Inventory on November 30 was only 3 percent more than a year ago.

Earnings for 1978, before taxes and unallocated expenses including interest, were $26.1 million for manufacturing and $21.5 million for retailing, as shown in the financial statements note on operating segment information. Our capitalization is about equally divided at approximately $125 million each, on which manufacturing earned 21 percent and retailing earned 17 percent.

Retail Stores Division
Sales of the Retail Stores Division, with 274 stores in 67 U.S. metropolitan areas, increased 7.9 percent to $375.4 million in 1978 from $348 million in 1977. These outstanding specialty stores are noted for their character and reputation in providing highly specialized service with a broad assortment of quality merchandise at competitive prices.

In July, 1978, Richard P. Hamilton, formerly president and chief executive officer of Florsheim Shoe Co., was appointed chairman and chief executive officer of our Retail Stores Division. Increased profitability and expansion will be stressed. New, more effective training programs will enhance our quality of service. Merchandising strategies, based on a combination of centralized worldwide selection of goods and individualized buying within each store group, will broaden our price ranges to provide the best clothing fashions for attracting the growing market of younger customers as well as our mature, affluent customers. A three-year program has commenced under which $25 million will be invested in additional stores and remodeling to increase sales productivity. Customers enjoy shopping in our stores, and our objective is to create a contemporary ambiance which appeals to them with imaginative displays of fine quality, fashionable merchandise and superior service.

Sales of Robert's, a high quality men's clothing manufacturer-retailer with 14 stores in Mexico, have been excluded after May, 1978 when it was "Mexicanized" by the public sale of shares, reducing our ownership from 77 to 49 percent and permitting expansion. Robert's has grown dramatically in five years, with sales tripling and profits quadrupling, measured in Mexican pesos. The write-down of

Jerome S Gore   John D Gray

assets to lower peso values offset most of our share of its earnings in 1977, but had no effect in 1978 Robert's expansion should compensate for our reduced ownership.

Manufacturing
Sales of our manufacturing divisions increased over 5 percent to $231.2 million in 1978 from $220 million in 1977. Total 1978 shipments were over $286 million, of which approximately $55 million or 20 percent was shipped to owned stores and, therefore, excluded from sales. All the manufacturing divisions must be creative and competitive in merchandise offerings to our stores, and our retail executives are helpful with recommendations and substantial advance orders. Independent customers also benefit from this profitable relationship.

Our manufacturing divisions, leaders in their price and fashion market segments, have gained in market share from 8 percent five years ago to 9 percent of the $3 billion U.S. men's tailored clothing industry. Hart Schaffner & Marx Clothes Division, with an impressive list of brand names, achieved another record year in sales and earnings. Hart Schaffner & Marx is the best known name in men's quality

clothing, and this label appears with the Christian Dior label and the famous Jack Nicklaus name. Austin Reed of Regent Street, Society Brand, Ltd. and Graham & Gunn, Ltd. also contributed large sales increases to the division in 1978.

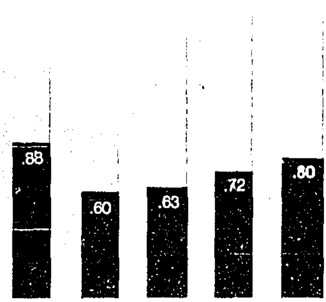
Hickey-Freeman, the outstanding manufacturer of the highest quality men's tailored clothing, increased sales for the third consecutive year. M. Wile produces moderately-priced suits and sport coats under the highly successful Johnny Carson and Nino Cerruti brands, as well as for private labels. Jaymar-Ruby, which features the famous Sansabelt slacks, is the largest manufacturer of quality slacks in the U S. Its unique Nino Cerruti Sport collection made a substantial contribution to Jaymar-Ruby's record sales in 1978. Gleneagles is an important maker of fashion rainwear and outerwear.

Our Whiteville, North Carolina plant has been converted from jeans to the manufacturing of popular-priced clothing and has been completely engineered for maximum efficiency. We are enthusiastic about the prospects for this new entry into this very substantial market segment by the new division, Whiteville Apparel Corporation.

Our manufacturing divisions take advantage of all important technological advancements, from computerized pattern making and cutting to automatic sewing, pressing and warehousing equipment. A worldwide demand exists for the Company's manufacturing know-how and marketing expertise in conjunction with its brand names. Licensing income, already in excess of $1 million annually, is growing. We are now working with licensees in Europe, North and South America and the Far East. Premier licensees include Marubeni Corporation, Asahi Chemical Industry Co., Ltd. and their sublicensees in Japan and Samsung in Korea.

Board of Directors

The board was changed from 14 to 12 directors in January, 1979. Robert J. Witt, an executive vice president and director, resigned to accept a position with another company Walter B. D. Hickey, Sr., although retiring as a director of Hart Schaffner & Marx, will continue as chairman of Hickey-Freeman Co., Inc. He has been a director since it was acquired in 1964 and has made an important contribution to our Company. His experience and advice have been valuable, and we are pleased that he will continue his association as an honorary director.



Outlook

The apparel industry is large and growing Americans will spend almost $100 billion for apparel and shoes during 1979 This is more than double the amount spent in 1970, although part of this is from inflation. Real growth should continue in the years ahead and we expect Hart Schaffner & Marx to participate in that growth

Fiscal 1979 started with a record December for our retail stores Sales increased 6 percent on top of a 16 percent increase a year ago. Our retail sales in January were 10 percent ahead of 1978. Manufacturing sales, based on advance orders for 1979, should also be above our record 1978 shipments, and consolidated sales and earnings should increase to new records in the first quarter of fiscal 1979. The Company has stated that it will support and comply with the wage and price guidelines, there appears to be no significant effect on our 1979 operations. Barring a significant slowdown in the economy and consumer spending, 1979 should be another good year for Hart Schaffner & Marx

Your Company has maintained a strong organization over the years, and we will continue to build for the future by attracting and promoting qualified employees. The performance of our employees in making our products and in serving our customers is basic to the success of Hart Schaffner & Marx. We want them to know that their efforts and dedication to the Company are deeply appreciated. Our directors join us in thanking them.

Very truly yours,

John D. Gray
Chairman

Jerome S. Gore
President and Chief Executive Officer

...chaffner & Marx Clothes

...ort coats, slacks and outercoats

Record sales and earnings were again achieved by the Hart Schaffner & Marx Clothes Divi- ... Hart Schaffner & Marx is the dom- ... quality clothing name throughout ... ountry; the exciting Jack Nicklaus ... ction and prestigious Christian ... yling contributed to the higher ... nd interest in the brand.

... brands participated in this ... ecord performance. Sales of ... Reed of Regent Street in- ... substantially, orders for 1979 ... en greater demand for this ... ook and styling. This name is ... d from Austin Reed Group, Ltd, ... owns the outstanding group of ... men's stores in the United ... om.

... e unique look and international ... pt of Society Brand, Ltd. have ... blished its position as the high ... n and quality brand in many fine ... and it has enjoyed record sales ... e consecutive years. Graham & ... Ltd , serving the fashion needs ... xclusive group of the finest ... cialty stores, continues to ... ugh existing customers and ... counts.

... Christian Dior Sport, a ... d but casual separates ... the regular Christian Dior ... enjoying great success.


THE BOND STREET

ickey-Freeman Co., Inc.

uits, sport coats, slacks, outercoats and ormalwear

Hickey-Freeman is benefiting from strong consumer interest in fine quality, sound value and lassic, elegant looks in fabrics and tyling The determination to maintain he highest possible level of quality nd skilled hand tailoring keeps ickey-Freeman firmly established in s quality leadership position

Demand for its clothing increased ales during 1978 and further in- eases are expected for 1979. New ccounts were added under Hickey- eeman, Walter-Morton and several ivate labels.

Consumer advertising was aug- nted by a national campaign during Hickey-Freeman and Walter- The New Yorker, Forbes, ountry and The Wall Street rogram was developed e brand exposure uent readers of those addition, the long- ogram of financial coop- ail customers in their ng continues to be the Hickey-Freeman's brand orts.

ompany, Inc.

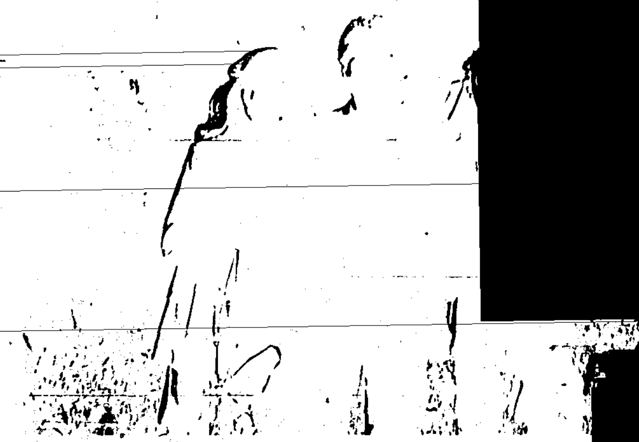
coats

M Wile & Company produces moderately priced suits and sport coats under nationally dvertised brand names and private bels.

Johnny Carson Apparel, Inc., 80 ercent owned by M Wile and 20 wned by Johnny Carson, complete line of men's nable apparel. Johnny Carson's ndous popularity and his appear- on television as well as in our vertising have promoted the dynamic growth of the Johnny Carson brand and in only eight years it has me one of the best known nation- dvertised apparel brands.

Eloquent contemporary fabrica- n young, sophisticated models ring European styled full-lined rments highlight the Nino Cerruti e Royale Collection. This line of n's suits and sport coats is enjoying nded distribution to such fashion ted stores as Bloomingdale's.

M. Wile's private label line has aken on more fashionable looks hrough the use of various concepts directed towards specific merchan- goals.



Ruby, Inc.

ort coats, suits and coordinated

A s the nation's largest manufacturer of men's quality slacks, Jaymar-Ruby enjoyed record sales in ... observed the 20th anniver- ...eir renowned Sansabelt, ...tures the unique triple ...aistband.

...portswear and slack collec- ...expanded and are now sold ...ds of stores throughout the ...separate sales force has ...lished to expand Nino ...ort, as sales of this inter- ...styled line have grown ...lly.

...or 1979, Ruby, Ltd., a collection ...ly-constructed sport coats, fea- ... new technique invented in ...erland. The Company has exclu- ...ights outside of Europe to pro- ...arments with this innovative ...s, which uses laminated self- ...onstruction to make the coat ...*weight and comfortable.*

eneagles, Inc.

nwear, outerwear and sportswear

G leneagles manufactures men's better rainwear, sportswear and outerwear bearing Glen- es, Christian Dior, Nino Cerruti ack Nicklaus labels. Its products atured in most of the better retail throughout the country.

leneagles, the fashion leader in quality rainwear, uses a variety ics, many imported, and con- ates on unique designs. The divi- has been especially successful coats designed by Christian Dior.

The Jack Nicklaus sportswear named for this prominent sports personality and all-time golfing cham- pion, continues to grow in sales of active golf-wear and spectator ap- parel. Gleneagles outerwear, featuring h fashion looks in rugged, climatic wear, continues to show strong as more time is devoted to activities.

...etail Stores Division

R etail Stores Division sales were a record $375 million in 1978, an increase of $27 million from ...348 million. Tailored clothing, ...rnishings, sportswear, women's and ...oes all contributed increases to the ...ercent higher sales.

The merchandise and design of ...en's and women's apparel stores ...road range of customers, ... middle to upper income ...ty branded apparel and ...shions created especially ...stomers are featured. Our ...elect about two-thirds of their ...ailored clothing from goods manufactured by the Company; the remaining one-third and all other merchandise are purchased from other resources. Record amounts of goods are being provided through Men's Market Merchandising ...poration and Women's Market ...chandising Corporation, our ...dwide buying services; this assists ...stores in offering quality apparel ...outstanding value, much of it designed and developed by our ...nel exclusively for sale by our ...

...r marketing research study on ...apparel purchases by price ...ries has resulted in the decision ...aden our merchandise base and ...ranges. Offerings of apparel will ...panded to attract young, fashion-...cious customers and also to ...al to more customers in the ...ature market.

The eighth R. J. Boggs store opened in September in Chicago's famous Water Tower Place. R. J. Boggs features carefully edited men's clothing, furnishings, and sportswear fashions of exceptionally good taste at ...oderate prices for the growing 20 to ...5 year age group. The ninth of these compact 2,500 square foot stores will open in spring, 1979 in Woodfield Mall, near Chicago.

Sales of women's apparel, including leased departments, exceeded $100 million in 1978. Chas. A. Stevens, which had five stores eight years ago, opened its 18th and 19th stores. The Division is operating 27 women's stores compared to 25 a year ago, and 142 of our 247 men's stores now have women's departments. We are encouraged with the opportunities to enlarge this area of our business.

Eight stores were opened in 1978, and ten locations, mostly with marginal prospects, were closed. There have been fewer new opportunities compared to 1977 when 22 stores were opened. Ten more stores are planned for 1979. In addition, we will update and remodel facilities in a number of our market areas. This effort will make these stores more attractive, add to sales productivity and make our warehouse and service facilities more efficient. Our new stores have a more open, contemporary look and are smaller, averaging approximately 6,000 square feet compared to 9,000 previously.

Each specialty store group is a profit center, with management responsible for taking full advantage of its own market potential. Divisional staff provides merchandising, advertising, accounting, credit, personnel, real estate, architectural and other advisory services. This combination of management talent enables our stores to respond effectively to both national and local market conditions.

Knowledgeable, helpful sales people, expert fitting and special attention to individual needs are distinctive features of our stores. In this era of impersonal assistance and self-service, our commitment to the skilled, friendly personal service our fashion products require and our customers expect stems from our belief that there is a bright future for our kind of specialty store.

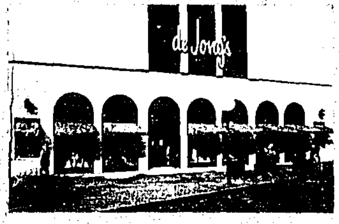
Robert's, the most successful quality men's apparel stores in Mexico, increased sales over 20 percent and earnings over 25 per... Although Robert's w... by the reduction in o... from 77 to 49 percen... association with Rob... ment, President Jorge S... Vice Presidents Jaime Po... Joaquin Shapiro, will conti... are now permitted to expa... enthusiastic about Robert'... growth.

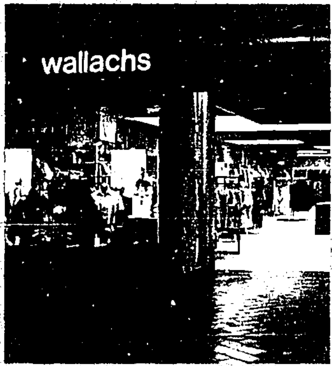
...ion Management
...ard P. Hamilton, *Chairman and Chief Executive Officer*
...C. (Chick) Schwartz, *Executive Vice President*
...A. DeChants, *Senior Vice President*
...K. Donnelly, *Senior Vice President*
...A. Miller, *Senior Vice President*
...Brenner, *Vice President*
...Coccodrilli, *Vice President*
...Donald R. Putnam, *Vice President*
Stan Smolan, *Vice President*
Harry B. Spiig, *Vice President*
Donald Wilson, *Vice President*

Men's Market Merchandising Co...
Matthew F. Shannon, *President*
Allan Baumel, *Vice President*
Howard B. Collins, Jr., *Vice Pres...*
Eugene L. Mellott, *Vice Presiden...*
O. Richards Quinn, *Vice Preside...*

Women's Market Merchandising Co...
Betty E. Green, *President*


CHAS. A. STEVENS


de Jong's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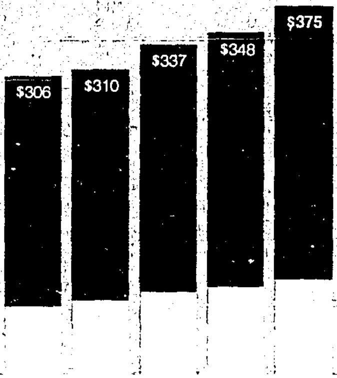
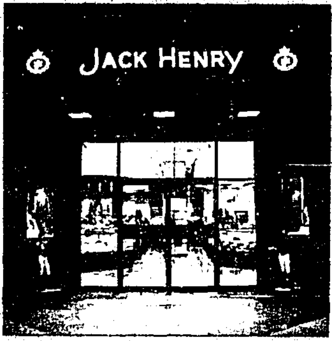
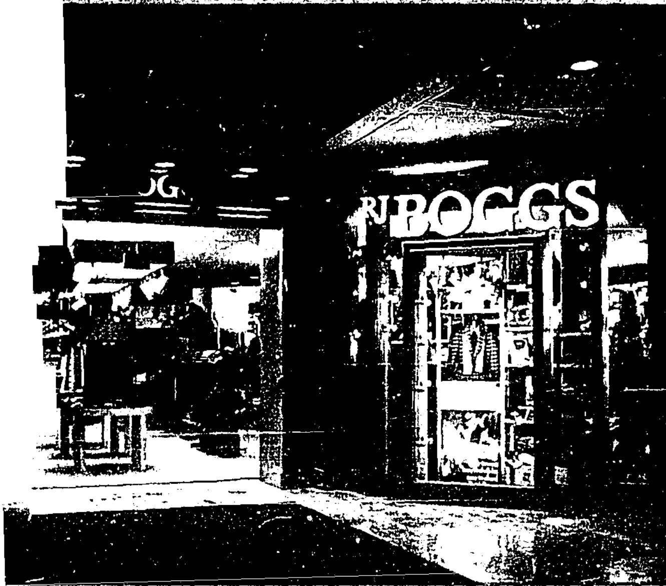
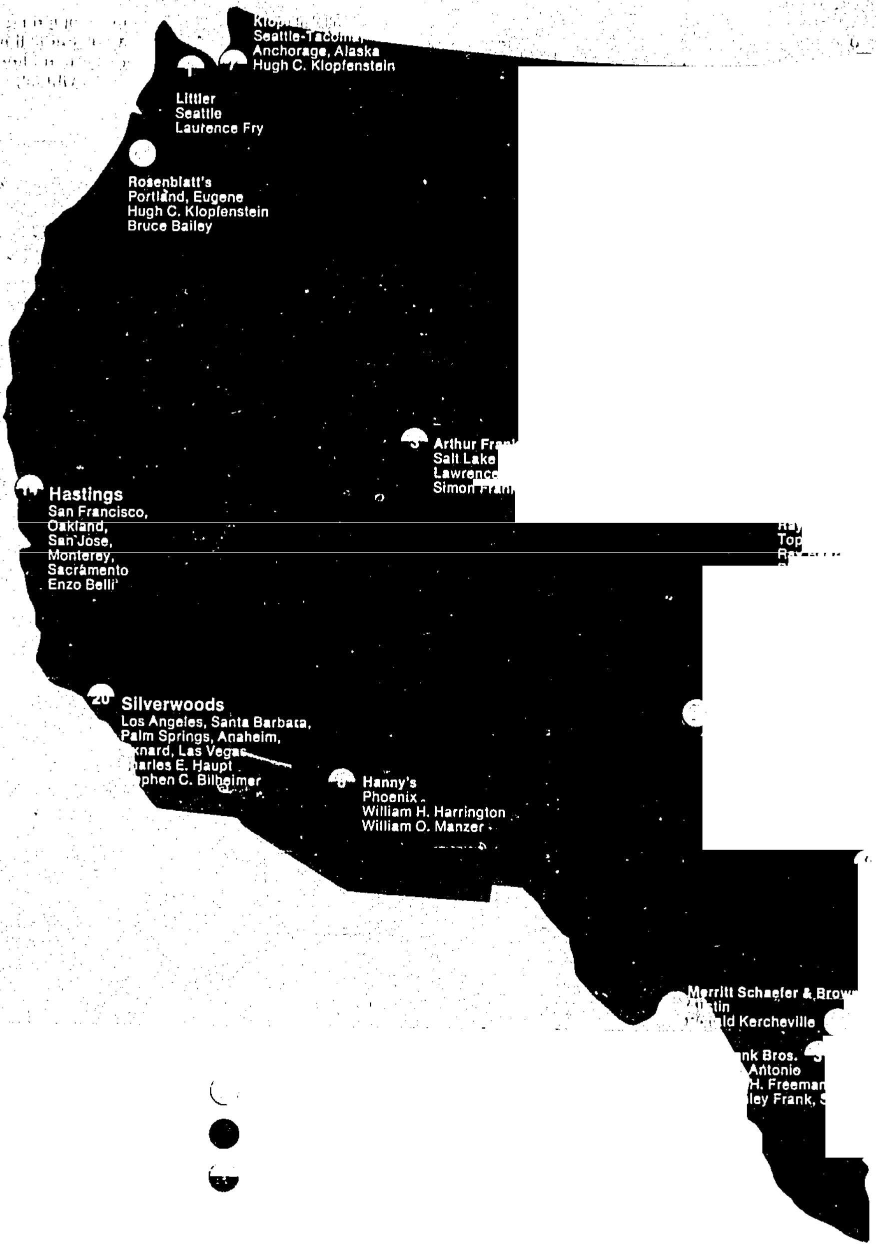

$306
$310
$337
$348
$375

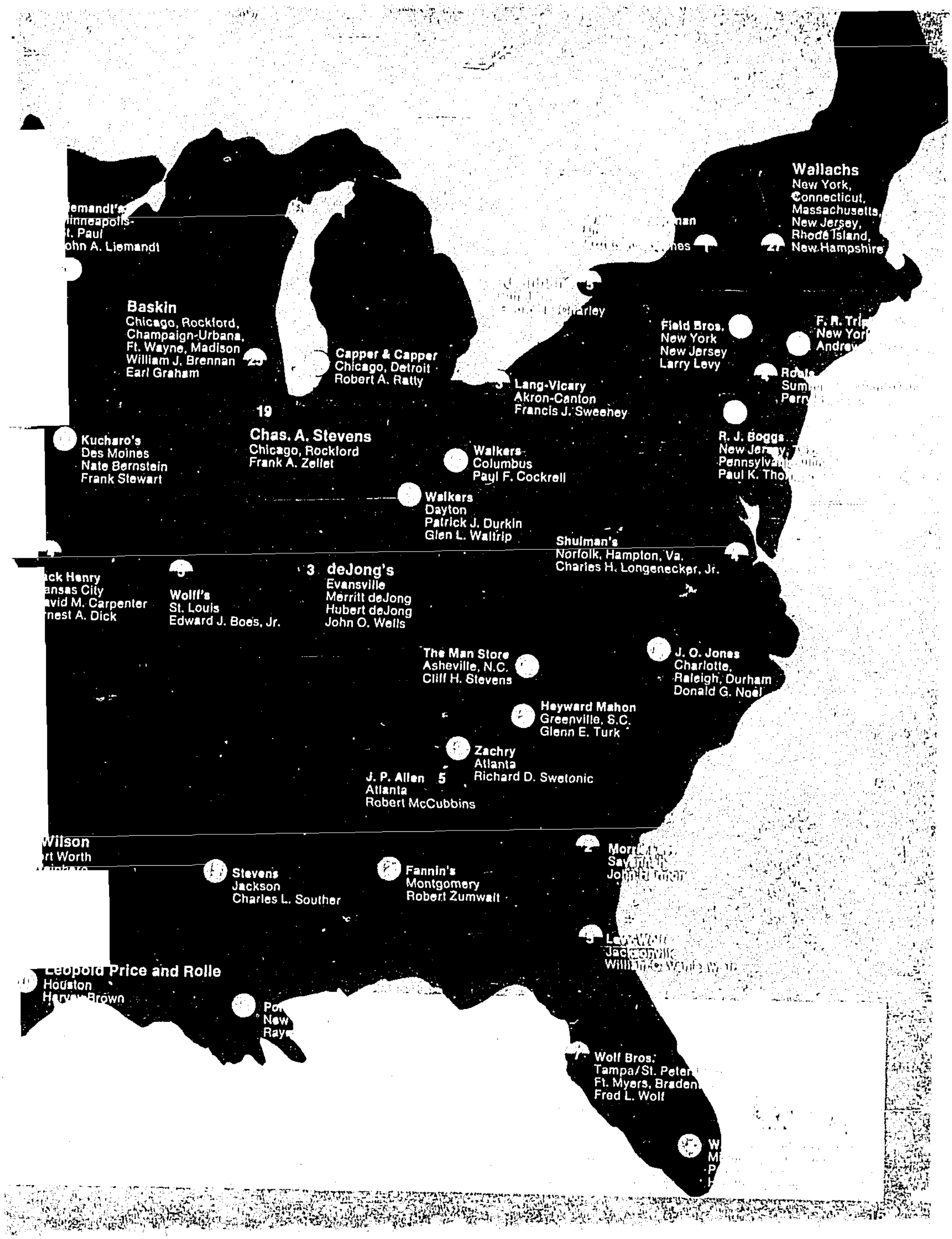

JACK HENRY


ROOTS


BOGGS


BASKIN


Anchorage, Alaska
Hugh C. Klopfenstein
Littler
Seattle
Laurence Fry
Rosenblatt's
Portland, Eugene
Hugh C. Klopfenstein
Bruce Bailey
Hastings
San Francisco,
Oakland,
San Jose,
Monterey,
Sacramento
Enzo Belli
Silverwoods
Los Angeles, Santa Barbara,
Palm Springs, Anaheim,
Hanny's
Phoenix
William H. Harrington
William O. Manzer


Wallachs
New York,
Connecticut,
Massachusetts,
New Jersey,
Rhode Island,
New Hampshire
John A. Liemandt
Baskin
Chicago, Rockford,
Champaign-Urbana,
Ft. Wayne, Madison
William J. Brennan
Earl Graham
Capper & Capper
Chicago, Detroit
Robert A. Ratty
Field Bros.
New York
New Jersey
Larry Levy
Lang-Vicary
Akron-Canton
Francis J. Sweeney
Kucharo's
Des Moines
Nate Bernstein
Frank Stewart
Chas. A. Stevens
Chicago, Rockford
Frank A. Zellet
Walkers
Columbus
Paul F. Cockrell
R. J. Boggs
Walkers
Dayton
Patrick J. Durkin
Glen L. Waltrip
Shulman's
Norfolk, Hampton, Va.
Charles H. Longenecker, Jr.
Wolff's
St. Louis
Edward J. Boes, Jr.
deJong's
Evansville
Merritt deJong
Hubert deJong
John O. Wells
The Man Store
Asheville, N.C.
Cliff H. Stevens
J. O. Jones
Charlotte,
Raleigh, Durham
Donald G. Noel
Heyward Mahon
Greenville, S.C.
Glenn E. Turk
Zachry
Atlanta
Richard D. Swetonic
J. P. Allen
Atlanta
Robert McCubbins
Wilson
Stevens
Jackson
Charles L. Souther
Fannin's
Montgomery
Robert Zumwalt
Price and Rolle
Houston
Wolf Bros.
Fred L. Wolf

Consolidated Statements of Earnings and Retained Earnings

Hart Schaffner & Marx and Subsidiary Companies

In Thousands / Years ended November 30	1978	1977	
Consolidated Statement of Earnings	$606,610	$567,986	Net sales
	6,792	6,220	Other income
	1,504	895	Interest income
	614,906	575,101	
	377,322	354,424	Cost of goods sold
	195,864	184,419	Selling, administrative and occupancy expenses
	5,765	5,523	Interest expense
	578,951	544,366	
	35,955	30,735	Earnings before taxes
	17,950	15,230	Taxes on earnings
	$ 18,005	$ 15,505	Net earnings
	$ 2.09	$ 1.80	Net earnings per common share and common share equivalent
	8,601	8,601	Average number of common shares and common share equivalents

Consolidated Statement of Retained Earnings	$146,987	$137,702	Retained earnings at beginning of year
	18,005	15,505	Net earnings for the year
			Cash dividends paid:
	(164)	(164)	Preferred shares, $2.00 per share
	(6,732)	(6,056)	Common shares, $ 80 per share in 1978 and $.72 per share in 1977
	$158,096	$146,987	Retained earnings at end of year

(See accompanying notes to consolidated financial statements)

Consolidated Balance Sheet
Hart Schaffner & Marx and Subsidiary Companies

In Thousands / November 30	1978	1977	
Assets			
Current Assets	$ 7,846	$ 14,459	Cash and short term investments
	105,400	102,889	Accounts receivable, less allowance of $5,267,000 and $4,885,000 for doubtful accounts
	164,356	159,238	Inventories
	1,778	2,111	Prepaid expenses
	279,380	278,697	**Total current assets**
Other Assets	4,075	4,108	
Properties	1,366	1,317	Land
	13,873	13,889	Buildings and building equipment
	75,717	73,199	Furniture, fixtures and equipment
	49,412	50,209	Leasehold improvements
	140,368	138,614	
	(85,203)	(80,865)	Accumulated depreciation and amortization
	55,165	57,749	**Net properties**
Total Assets	$338,620	$340,554	
Liabilities and Shareholders' Equity			
Current Liabilities	$ 2,000	$ 11,500	Notes payable to banks
	4,831	1,090	Current maturities and early retirements of long term debt
	68,849	68,696	Accounts payable and accrued expenses
	3,806	3,119	Taxes on earnings
	5,460	5,550	Deferred taxes on earnings
	84,946	89,955	**Total current liabilities**
Long Term Debt	53,723	61,807	Long term debt, less current maturities and early retirements
Shareholders' Equity	82	82	Convertible preferred shares, $1 par value; authorized 2,500,000; issued and outstanding, Series A, 82,016 in 1978 and 82,066 in 1977
	21,705	21,695	Common shares, $2.50 par value; authorized 25,000,000; issued 8,682,080 in 1978 and 8,678,190 in 1977
	23,578	23,552	Capital surplus
	158,096	146,987	Retained earnings
	203,461	192,316	
	(3,510)	(3,524)	Common shares in treasury, at cost, 264,663 in 1978 and 265,714 in 1977
	199,951	188,792	**Shareholders' Equity**
Total Liabilities and Shareholders' Equity	$338,620	$340,554	

(See accompanying notes to consolidated financial statements)

Consolidated Statement of Changes in Financial Position

Hart Schaffner & Marx and Subsidiary Companies

In Thousands / Years ended November 30	1978	1977	
Working Capital was Provided by:	**$18,005**	$15,505	Net earnings for the year
	8,792	8,300	Depreciation and amortization
	560	(44)	Other
	27,357	23,761	Working capital provided by operations
	—	7,950	Proceeds from long term borrowing
	27,357	31,711	
Working Capital was Used for:	**8,084**	1,090	Reduction of long term debt
	6,896	6,220	Payment of dividends
	6,685	10,686	Property additions—net
	21,665	17,996	
Increase in Working Capital	**$ 5,692**	$13,715	

Changes in Components of Working Capital:	**$(6,613)**	$(1,789)	Cash and short term investments
	2,511	6,549	Accounts receivable
	5,118	15,101	Inventories
	(333)	45	Prepaid expenses
	9,500	2,500	Notes payable to banks
	(3,741)	(150)	Current maturities and early retirements of long term debt
	(153)	(8,712)	Accounts payable and accrued expenses
	(687)	2,481	Taxes on earnings
	90	(2,310)	Deferred taxes on earnings
Increase in Working Capital	**$ 5,692**	$13,715	

(See accompanying notes to consolidated financial statements)

Report of Independent Accountants

To the Shareholders and Board of Directors of Hart Schaffner & Marx

Notes to Consolidated Financial Statements November 30, 1978 and 1977

Summary of Accounting Policies

The consolidated financial statements include the accounts of the Company and all subsidiaries. The Company's investment in Robert's S.A. de C.V., a Mexican corporation, has been accounted for under the equity method since May, 1978 when its ownership interest was reduced from 77% to 49% by a public sale of shares in Mexico.

Inventories are stated at the lower of cost or market. Cost is determined by the use of the last-in, first-out (LIFO) method for a substantial quantity of the manufacturing and retail store inventories and it is the primary method used by the Company. For the remaining inventories, the first-in, first-out (FIFO) method is used for manufacturing and the retail method is used for retail stores.

The excess of current costs over LIFO costs for certain inventories increased during 1978 by $2.1 million; if current costs had been used, inventories would have been higher by approximately $7 million at November 30, 1978, compared to $4.9 million higher at November 30, 1977, $3.4 million at November 30, 1976 and $1.8 million at November 30, 1975 and 1974.

Properties are stated at cost. Additions, major renewals and betterments are capitalized; maintenance and repairs which do not extend asset lives are charged against earnings. Profit or loss on disposition of assets is reflected in earnings and the related asset costs and accumulated depreciation are removed from the respective accounts except for certain assets for which the composite method of computing depreciation is used under which no gain or loss is recognized on disposition.

Accelerated depreciation methods are used for a significant portion of the properties and the straight line method is used for the remainder. Depreciation is computed based on useful lives of 20 to 45 years for buildings, 5 to 20 years for building equipment and 3 to 15 years for furniture, fixtures and equipment. Amortization of leasehold improvements is based upon the terms of the respective leases.

Deferred taxes on earnings are provided for timing differences between financial and taxable income. Investment tax credits are recognized as a reduction of the current provision for taxes on earnings in the year related assets are placed in service.

The Company and its subsidiaries maintain pension plans covering substantially all employees other than those covered by union-sponsored plans. Pension expense charged against earnings includes current service costs and, as to plans not fully funded, amortization of prior service costs over periods ranging from ten to thirty years. Pension costs are funded as accrued.

Earnings per share are computed based on the average number of common shares and common share equivalents outstanding. Convertible preferred shares have been included as common share equivalents. When dilutive, stock options are included as share equivalents using the treasury stock method.

Long Term Debt

At November 30, 1978 and 1977, long term debt, less current maturities and early retirements of $4,100,000 of the 8½% debentures purchased after November 30, 1978, was comprised of the following (000's omitted):

1978	1977	
$25,348	$32,700	8½% sinking fund debentures (due 1996)
25,000	25,000	9¼% promissory notes (due 1991)
3,375	4,107	Other debt, extending to 1991 (average interest rate of 5½%)
$53,723	$61,807	

The Company has purchased $9,652,000 of the 8½% sinking fund debentures, at varying discounts, reducing the principal amount from the original $35,000,000 to $25,348,000. Retirements of $1,750,000 annually commenced February 15, 1978 and $3,500,000 of the purchases have been applied to the 1978 and 1979 sinking fund requirements, leaving $6,152,000 for future use.

The 9¼% promissory notes require annual payments of $1,400,000 on December 1, 1981, 1982 and 1983 and $2,600,000 annually each December 1 thereafter. The Company may make optional prepayments without premium in amounts equal to and at the dates of the required payments, not to exceed $7,500,000 in the aggregate, and may make additional prepayments, subject to certain restrictions prior to November 1, 1985, of all or any portion of the notes at varying premiums.

Under the most restrictive provisions of the Company's borrowing agreements, the Company may incur total funded debt up to approximately the amount of shareholders' equity. At November 30, 1978 senior funded debt was limited to approximately $178 million. In addition, at November 30, 1978 consolidated working capital was $194 million compared to $81 million required to be maintained by the Company. Consolidated retained earnings of $34,300,000 at November 30, 1978 plus 80% of earnings thereafter are available for the payment of future cash dividends.

Leases

The Company and its subsidiaries operate principally in leased facilities. Over 90 percent of all leases provide for payment by the lessors of all or most of the applicable real estate taxes, maintenance and insurance costs, which are substantial in proportion to the minimum rentals. At November 30, 1978, total minimum rentals under all noncancelable leases and rentals applicable to capital leases, all net of sublease income, are as follows (000's omitted):

Capital Leases	All Leases	Years
$ 564	$13,039	1979
561	12,672	1980
558	12,329	1981
597	11,827	1982
722	11,376	1983
3,313	43,112	1984-1988
1,994	21,493	1989-1993
467	4,496	1994-1998
480	1,990	Thereafter

Rental expense, including rentals under short term leases, was comprised of the following (000's omitted):

1978	1977	
		Capital Leases
$ 749	$ 749	Minimum rentals
128	105	Contingent rentals
(200)	(208)	Sublease (income)
		Operating Leases
14,308	15,015	Minimum rentals
5,390	4,244	Contingent rentals
(792)	(716)	Sublease (income)
$19,583	**$19,189**	**Total rental expense**

Almost one-half of the leases contain renewal options ranging from 5 to 25 years; several leased facilities may be purchased at various dates at an aggregate cost of $5,200,000. Contingent rental payments are generally based on the sales volume of the rental unit.

The present value of capital lease commitments was $4.6 million at November 30, 1978 and $4.9 million at November 30, 1977. The weighted average of interest rates used to compute present value was 5.1% and the range was 3.5% to 7.5% in both years.

The Financial Accounting Standards Board's statement concerning Accounting for Leases includes a requirement, effective for the Company in 1979, that the present value of capital leases be retroactively recorded as fixed assets and liabilities. Had the rental properties which are classified as capital leases been capitalized, amortized and interest accrued on the basis of the outstanding lease commitments, the effect on net earnings in 1978 and 1977 would have been insignificant.

Operating Segment Information

The Company is engaged in the business of manufacturing and selling apparel. Approximately 20% of its manufactured products are sold to consumers through its own retail stores that also sell goods purchased from others, and 80% are sold to other retailers for resale to consumers. No one customer accounts for 10% or more of consolidated sales. Information on the Company's manufacturing and retailing operations for the year ended November 30, 1978 is summarized as follows (in millions):

	Manufacturing	Retailing	Adjustments	Consolidated
Sales to unaffiliated customers	$231 2	$375 4	$	$606 6
Earnings before taxes	26.1	21 5	(11 6)	36.[illegible]
Gross assets at year end	160 6	188.7	(10.7)	338.[illegible]
Depreciation and amortization	3 5	5 3		8 8
Property additions—net	2 5	4.2		6 7

Shipments of approximately $55 million to the Company's retail stores (at the same prices as similar items sold to unaffiliated retailers) are excluded from manufacturing sales, although profit on these products is included in manufacturing earnings. Deductions from earnings before taxes are for $4.3 million interest expense (net of interest income) and for $7.3 million of overall management expenses and intercompany profit elimination. Deductions from gross assets are for intercompany profit in inventory and intercompany receivables, less corporate cash and other assets.

Taxes on Earnings

The provision for taxes on earnings is summarized as follows (000's omitted)

1978	1977	
		Current
15 300	$10,520	Federal
2,130	1,500	State and other
610	900	Foreign
18,040	12,920	**Total current**
		Deferred
(80)	2,040	Federal
(10)	270	State and other
(90)	2,310	**Total deferred**
17,950	$15,230	**Total taxes on earnings**

The 1977 deferred tax provision primarily comprises the reversal of tax prepayments of $1,200,000 and deferral of $1,000,000 attributable to deferred gross margin on instalment sales. The items comprising the 1978 deferred tax provision are all insignificant.

The effective tax rate was 49.9% in 1978 and 49.6% in 1977. The difference between taxes on earnings reflected in the accompanying statement of earnings and the amount computed by applying the federal statutory tax rate to pre-tax earnings is summarized as follows:

Percent of Pre-tax Earnings

1978	1977	
48.0%	48 0%	Taxes computed at statutory rate
3.1	3 0	State and other taxes on earnings, net of federal tax benefit
(1.4)	(2.6)	Investment tax credit (approximately $500,000 in 1978 and $800,000 in 1977)
.2	1.2	Other—net
49.9%	49 6%	

Stock Option Plans

The Company has stock option plans under which officers and key employees may be granted options to purchase the Company's common stock at prices equal to the fair market value at date of grant. Options under all plans are exercisable to the extent of 25% each year (cumulative) from the second through the fifth year, and expire five to ten years after date of grant. A total of 403,946 common shares were reserved at November 30, 1978 for options granted or to be granted.

A summary of the plans for the year ended November 30, 1978 is as follows:

Number of shares under option	Range of option prices per share	
419,635	$ 6.38 to $26 88	Under option at beginning of year
78,608	11 13 to 12 94	Granted
(3,800)	6.57 to 10.07	Exercised
(101,135)	6 57 to 26.88	Expired or terminated
393,308	$ 6 38 to $14 13 (average of $11.67)	Under option at end of year

Options exercisable at end of year	203,931
Available for grant:	
Beginning of year	34,771
End of year	10,638

Pension Plans

The Company's principal plan requires contributions by the employees and another pension plan permits voluntary employee contributions. Except for several deferred profit sharing plans of subsidiaries, all employer contributions are based on actuarial determinations.

Total pension costs for the years ended November 30, 1978 and 1977 were approximately $2,650,000 and $2,550,000 respectively, excluding contributions to union-sponsored plans. At November 30, 1978, the amount funded exceeded the actuarially computed total of vested benefits and the unfunded past service liability was approximately $1,900,000. Contributions to union-sponsored plans are made by the Company and certain subsidiaries pursuant to industry-wide collective bargaining agreements.

Convertible Preferred Shares

Series A preferred shares are voting shares, each convertible into 1.8 common shares and are cumulative with an annual $2 dividend rate. The shares are callable at a liquidation price of $67 50 each (an aggregate of $5,536,000 at November 30, 1978) and 147,629 common shares are reserved for conversion. During 1978, 50 preferred shares were converted into 90 common shares.

Replacement Cost Information (Unaudited)

In compliance with the regulations of the Securities and Exchange Commission, the Company has estimated the replacement cost of inventories, productive capacity (plant and equipment) and retail facilities as of November 30, 1978 and the approximate effect such replacement costs would have had on cost of goods sold and depreciation expense for the fiscal year then ended. The replacement cost of inventories, productive capacity and retail facilities would be higher than book values. Although an exact calculation of the effect upon operations of complete replacement is not possible, efficiencies from replacing manufacturing plants and equipment plus increased sales from enhanced retail facilities generally offset the higher cost of goods sold and depreciation expense related to such replacements. The Company's annual report to the Securities and Exchange Commission on Form 10-K contains detailed information regarding replacement costs.

Quarterly Financial and Common Share Information

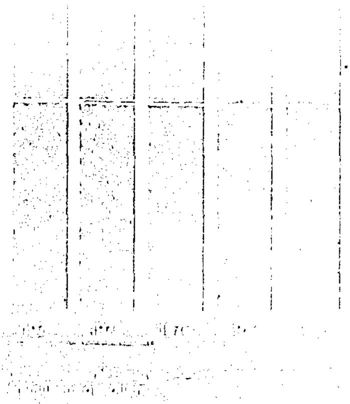
Hart Schaffner & Marx and Subsidiary Companies

Quarters	Net Sales		Gross Profit		Net Earnings				Cash Dividends	
(Not separately audited)	(000's omitted)		(000's omitted)		(000's omitted)		Per Share		Per Share	
	1978	1977	**1978**	1977	**1978**	1977	**1978**	1977	**1978**	1977
First	**$165,576**	$147,840	**$ 62,122**	$ 56,265	**$ 5,860**	$ 4,740	**$ .68**	$ .55	**$ .20**	$ .18
Second	**133,315**	128,004	**52,934**	49,514	**3,765**	3,070	**.44**	.36	**.20**	.18
Third	**146,818**	131,267	**52,783**	48,121	**3,290**	2,787	**.38**	.32	**.20**	.18
Fourth	**160,901**	160,875	**61,449**	59,662	**5,090**	4,908	**.59**	.57	**.20**	.18
Total	**$606,610**	$567,986	**$229,288**	$213,562	**$18,005**	$15,505	**$2.09**	$1.80	**$ .80**	$ .72

Hart Schaffner & Marx common shares are traded under the symbol HSM on the New York and Midwest Stock Exchanges. The quarterly composite price range for the past two years was:

	Fiscal 1978				Fiscal 1977			
	Fourth	**Third**	**Second**	**First**	Fourth	Third	Second	First
High	**$16**	**$15**	**$14⅛**	**$12**	$12¾	$13¼	$14⅜	$14½
Low	**10**	**12**	**10¾**	**10¾**	11	11¾	11⅞	11⅝

Series A cumulative preferred shares, on which quarterly $.50 cash dividends were paid in 1978 and 1977, while not separately traded, are each convertible into 1.8 common shares.



Management's Analysis of Results

Consolidated sales increased 6.8 percent to $606.6 million in 1978 from $568 million in 1977. Earnings increased $2.5 million or 16.1 percent to $18,005,000 or $2.09 per share from $15,505,000 or $1.80 per share. Manufacturing, retailing and consolidated sales and earnings for 1978 were all records. Consolidated net earnings increased to 3.0 percent from 2.7 percent of sales. This improvement resulted from lower cost of goods sold and lower expenses in relation to sales and from higher interest income.

The "Operating Segment Information" note to the financial statements shows manufacturing and retailing separately. Manufacturing sales to unaffiliated customers were $231.2 million or 38 percent of consolidated sales in 1978. In addition, the manufacturing divisions shipped more than $55 million to the Company's retail stores, and these shipments were excluded from consolidated sales. Sales to independents were 80 percent of total manufacturing shipments and owned stores accounted for 20 percent of total shipments. These products manufactured by the Company represent approximately 30 percent of the total retail sales of our stores.

Retail sales were $375.4 million or 62 percent of consolidated sales in 1978. Earnings are usually lower in retailing as a percentage of sales. Gross assets are shown in the "Operating Segment Information" at November 30, and are more in retailing because retail inventories are at a peak before Christmas. Accounts payable and accruals are also higher for retailing; the average amount invested in each segment is approximately the same. The Company's 20,000 employees are also almost equally divided between the retailing and manufacturing segments.

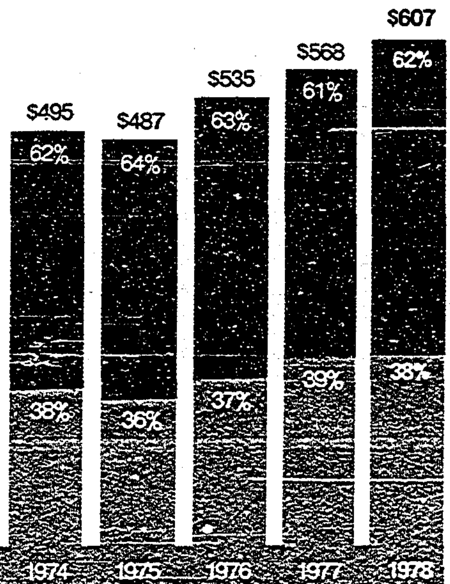
Manufacturing sales increased over 5 percent to $231.2 million in 1978 from $220 million in 1977 compared to $200 million in 1976. Retail Stores Division sales increased 7.9 percent to $375.4 million in 1978 from $348 million in 1977 compared to $337 million in 1976. The consolidated sales increase of 6.8 percent and earnings increase of 16.1 percent in 1978 represent continued improvement compared to the 1977 increases of 6.2 percent in sales and 12 percent in earnings. Sales and earnings increased in each quarter during the past three years. The record 1978 fourth-quarter sales and earnings were accomplished after reductions caused by earlier shipments of fall, 1978 goods by the manufacturing divisions and the exclusion of sales of Robert's, our Mexican affiliate. Robert's sales were approximately $10.6 million for the year 1978, of which only the first half's $5.3 million was included in consolidated sales.

Some of the sales increases in each of the years were from higher prices, but more sales of moderately-priced merchandise partly offset this. Margins increased in both 1978 and 1977, due to improved production and markups. Cost of goods sold decreased to 62.2 percent of sales in 1978 compared to 62.4 percent in 1977 and 62.7 percent in 1976. Selling, administrative and occupancy expenses were also lower in 1978, at 32.3 percent of sales compared to 32.5 percent in 1977 and 32.4 percent in 1976.

Earnings before taxes increased to 5.9 percent in 1978 from 5.4 percent in 1977 and 5.2 percent in 1976. In addition to the .2 percent improvement in cost of goods sold and .2 percent improvement in expenses in 1978, interest and other income increased by .1 percent of sales. Interest income increased to $1,504,000 from $895,000 primarily from short term investing of cash. This $609,000 increase more than offsets a $242,000 increase in interest expense, primarily resulting from $8 million more of 9¼ percent notes outstanding throughout 1978 compared to only half of 1977. Interest expense will now be lower on long term debt, which has been reduced to $53.7 million from $61.8 million a year ago.

Service charges on receivables accounted for most of the remaining increase in other income in both 1978 and 1977. Other income also includes gains and losses on asset dispositions and in 1978 there was a capital gain on the sale of Robert's shares which was offset by a write-down of assets resulting from the Whiteville plant conversion. The Company publicly sold shares of Robert's in Mexico, which reduced the Company's ownership from 77 percent to 49 percent in May, 1978 and resulted in a net capital gain of almost three cents per share. Robert's financial statements were excluded from consolidation during the last half of 1978 when the Company's equity in Robert's earnings was included in other income.

Taxes on earnings as a percent of pre-tax earnings were 49.9 percent in 1978 and 49.6 percent in 1977, compared to the relatively high 50.6 percent in 1976. Investment tax credits were larger in 1977 when property additions were higher. As a result of the fixed asset additions and greater use of accelerated depreciation, depreciation and amortization increased to $8.8 million in 1978 and $8.3 million in 1977 from $7.5 million in 1976.



Retail Stores and Manufacturing Sales in millions of dollars

● Retail Stores Division Percent of Total Sales
○ Manufacturing Division Percent of Total Sales

(See Five-Year Consolidated Summary of Operations on page 24)

Five Year Consolidated Summary of Operations
In Thousands

Years ended November 30	**1978**	1977	1976	1975	1974
Net sales	**$606,610**	$567,986	$534,609	$486,833	$494,93
Interest and other income	**8,296**	7,115	6,360	5,184	5,299
	614,906	575,101	540,969	492,017	500,233
Cost of goods sold	**377,322**	354,424	335,435	305,720	310,150
Selling, administrative and occupancy expenses	**195,864**	184,419	173,209	163,363	159,958
Interest expense	**5,765**	5,523	4,275	6,614	6,979
	578,951	544,366	512,919	475,697	477,087
Earnings before taxes	**35,955**	30,735	28,050	16,320	23,14
Taxes on earnings	**17,950**	15,230	14,200	8,010	11,39
Net earnings	**$ 18,005**	$ 15,505	$ 13,850	$ 8,310	$ 11,755
Net earnings per common share and equivalent	**$ 2.09**	$ 1.80	$ 1.61	$ .97	$ 1.36
Cash dividends paid on:					
Preferred shares	**$ 164**	$ 164	$ 164	$ 164	$ 16
Common shares	**$ 6,732**	$ 6,056	$ 5,298	$ 5,044	$ 7,4
Per share	**$ .80**	$ .72	$ .63	$ .60	$ .88
Average number of common shares and equivalents	**8,601**	8,601	8,588	8,558	8,637

Corporate Officers
Hart Schaffner & Marx

John D. Gray
Chairman of the Board

Jerome S. Gore
President and Chief Executive Officer

Richard P. Hamilton
Executive Vice President

John R. Meinert
Executive Vice President

Jerome Dorf
Vice President and Controller

Ralph Kaufmann
Vice President

Howard V. Knicely
Vice President

Mark J. Lies
Vice President and Treasurer

William J. McNally, Jr.
Vice President

Charles L. Stewart
Vice President, Secretary and General Counsel

Raymond L. Valentine, Jr.
Vice President

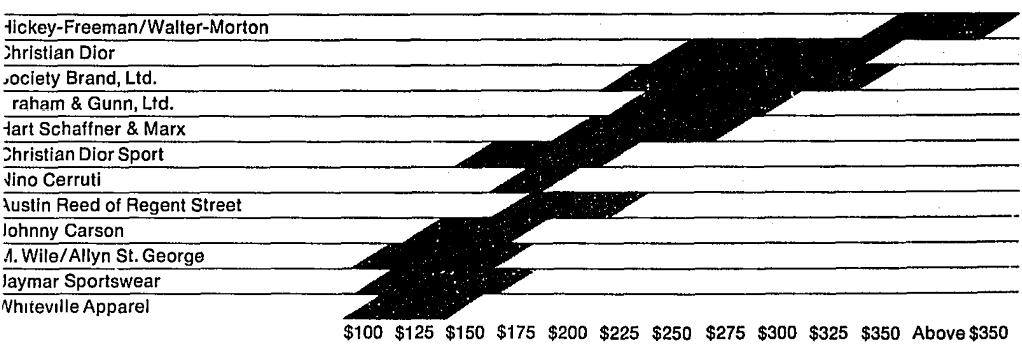
Edward R. Weed
Vice President

Roger H. Clausen
Assistant Controller

Andrew A. Zahr
Assistant Controller

Kay C. Nalbach
Assistant Secretary

Harrison Hanson
Director of Computer Systems



Retail Price Ranges of Suits by Brand